



Review of Dominion Energy South Carolina, Inc.'s Gas Rate Stabilization Act Monitoring Report

South Carolina
Office of Regulatory Staff

2019



**Review of Dominion Energy South Carolina, Inc.'s
Gas Rate Stabilization Act Monitoring Report
For the period ending March 31, 2019**

Pursuant to S.C. Code Ann. Section 58-5-455(3)

August 30, 2019

South Carolina Office of Regulatory Staff

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Introduction

On February 16, 2005, the Natural Gas Rate Stabilization Act ("RSA"), S.C. Code Ann. § 58-5-400, was signed into law. The South Carolina Office of Regulatory Staff ("ORS"), in accordance with the RSA, conducted an examination of Dominion Energy South Carolina, Inc.'s ("DESC" or "the Company") Monitoring Report for the twelve-month period ended March 31, 2019 ("Review Period"). The examination was conducted for the purpose of determining the Company's compliance with the provisions of the RSA.

Pursuant to the RSA, the Company must file Monitoring Reports with the Public Service Commission of South Carolina ("Commission") and the ORS on or before the fifteenth of June. In Docket No. 2019-6-G, DESC filed its Monitoring Report with the Commission on June 14, 2019 ("Company's Request"). The Company reported in its March 31, 2019 Monitoring Report an adjusted rate of return and return on common equity of 7.23% and 8.58%, respectively. The Company's calculation of an increase in revenue requirements totaled \$7,106,649.

In accordance with the RSA, ORS's audit reports are provided to the Commission, the Company, and made available to all interested parties no later than the first of September. ORS's review of DESC's Monitoring Report focused on the Company's adherence to the RSA and applicable Commission Orders. This report details the results of ORS's examination.

ORS appreciates the Company's efforts to present its books and records in an accurate and transparent manner. DESC's responses to ORS's discovery and questions were timely. ORS met with the Company on August 19, 2019, to discuss the results of ORS's examination.

RSA Rates History

In accordance with the guidelines of the RSA, the Company is entitled to an adjustment in rates to achieve a return on common equity as set by previous Commission Order, currently 10.25%. Table 1 shows the requested and approved changes granted for prior RSA filings and a comparison to the current filing.

Table 1:

Docket No.	Order No.	Amount Requested	Resulting Revenue with Adjustments	Amount Granted	Approved Return on Equity	Rates Effective
2014-6-G	2014-821	(\$2,997,170)	(\$2,647,323)	(\$2,647,323)	10.25%	11/1/2014
2015-6-G	2015-731	\$0	\$0	\$0	9.85%	11/1/2015
2016-6-G	2016-704	\$4,386,695	\$4,086,147	\$4,086,147	10.25%	11/1/2016
2017-6-G	2017-623	\$9,022,098	\$8,633,538	\$8,633,538	10.25%	11/1/2017
2018-6-G	2018-678	(\$18,737,191)	(\$19,716,936)	(\$19,716,936)	10.25%	11/1/2018
2019-6-G	TBD	\$7,106,649	\$6,273,054	TBD	10.25%	11/1/2019

ORS Review

ORS examines the operating experience reported by the Company for the Review Period together with the associated revenue requirement calculations. The results of ORS's examination of the Monitoring Report and the underlying financial records through March 31, 2019, are contained in **Schedule 1**.

Schedule 1 presents the Company's operating experience, rate base and rates of return for the Review Period, and the accounting and pro forma adjustments that ORS has determined are necessary to normalize the Company's operations.

Utilizing the per book rate base of \$668,033,029 and income of \$43,873,694, a rate of return was calculated on per book operations of 6.57% with a corresponding return on common equity of 7.22%. ORS accounting and pro forma adjustments increased net income for return to \$48,784,094 and decreased rate base to \$666,288,427. A rate of return of 7.32% and a return on common equity of 8.78% were computed by ORS. After the adjustments for the proposed margin increase of \$6,273,054, net income for return increased to \$53,551,048. The rate of return on rate base computed by ORS after the adjustments for the proposed increase is 8.04%. The return on common equity is 10.25%.

Schedule 2 presents an explanation of the accounting and pro forma adjustments ORS recommends for the Company's Monitoring Report to conform to S.C. Code Ann. § 58-5-450. For comparative purposes, the adjustments of both the Company and ORS are presented on Schedule 2.

Schedule 3 presents the calculation of the weighted cost of capital used by ORS in calculating the Company's return on common equity both before and after ORS's adjustments for the proposed margin increase. The rate base, as shown on Schedule 1, is allocated between long-term debt and common equity using the Company's actual capital structure of 48.54% Common Equity and 51.46% Long-Term Debt for the Review Period. The adjusted amount of total income for return necessary to cover an embedded cost rate of 5.95% on long-term debt is computed to be \$20,400,885. The remainder of the total income for return of \$28,383,209 is income to common equity. This produced a return of 8.78% on common equity before the proposed increase. The overall cost of capital after accounting and pro forma adjustments, prior to the proposed increase, is 7.32%. The cost of capital after the proposed increase equals 8.04%.

Non-allowable Expenses

DESC proposed a non-allowable adjustment of (\$53,106). In compliance with DESC policy, DESC records expenses the Company identifies as non-allowable and non-utility related "below-the-line." ORS's proposed non-allowable expense Adjustment #22 is (\$306,978). Below is a description of the categories of non-allowable expenses identified by ORS.

- Company Agrees – Expenses ORS selected for testing for which the Company agreed were non-allowable expenses.¹
- Insufficient documentation – Expenses ORS selected for testing for which the Company did not provide adequate support. Items were disallowed due to no list of attendees on sign-in sheet, no clear business purpose on agenda, no itemized receipt or no third-party documentation.
- Development Grants and Sponsorships – Costs of sponsorships and grants to non-profit organizations that do not directly relate to the provision of safe and reliable gas operations or increase total system sales and customers.
- Normalize Review Period Expenses – Expenses incorrectly allocated to the Review Period.
- Incorrect Allocation to South Carolina Gas Operations – Expenses incorrectly allocated to South Carolina Gas Operations.
- Excessive Operating Expenses – Excessive expenses not considered necessary for the provision of gas service to customers such as first-class plane tickets and an onsite café contract.

¹ DESC may not agree with the balance of ORS's proposed Adjustment #22.

- Entertainment or non-essential employee benefits – Expenses not considered necessary for the provision of gas service to customers such as valet parking and membership and association dues for non-professional organizations.

Table 2 below provides a summary of the non-allowable expense adjustments made by ORS.

Table 2:

Category	Amount
DESC's Non-Allowable Expense Adjustment #22	(\$53,106)
<i>Additional Adjustments Proposed by ORS:</i>	
Company Agrees	(\$103,555)
Insufficient Documentation	(\$19,056)
Development Grants and Sponsorships	(\$34,501)
Normalize Review Period Expenses	(\$89,298)
Incorrect Allocation to South Carolina Gas Operations	(\$3,064)
Excessive Operating Expenses	(\$3,355)
Entertainment or Non-essential Employee Benefits	(\$1,043)
ORS's Non-Allowable Expense Adjustment #22	(\$306,978)

Employee Incentive Pay and Executive Salary

Order No. 2005-619 included an adjustment to reduce employee incentive pay. In subsequent annual RSA filings, DESC proposed an adjustment to reduce employee incentive pay; however, in this annual RSA filing DESC did not include any adjustment to employee incentive pay. ORS's Adjustment #23 for incentive pay and executive's salaries and benefits totals (\$566,955).

ORS recommends an adjustment of (\$237,172) to remove the portion of Long-Term Incentives and Short-Term Incentives for all employees allocated to South Carolina natural gas operations for the Company's Earnings Per Share ("EPS") and Total Shareholder Return ("TSR") goals. ORS's recommendation to exclude incentive compensation expenses associated with EPS and TSR is based on the following rationale: 1) payments for earnings goals is not certain; 2) earnings can be influenced greatly by factors such as customer growth and higher authorized returns which are not directly attributed to the actions of Company employees; and 3) incentive payments to employees should be made using increased earnings not through customer rates.

ORS also recommends an adjustment of (\$329,783) to remove fifty percent (50%) of the base pay and benefits paid to the Company's four (4) highest compensated executives allocated to the Company's South Carolina natural gas operations. These four (4) executives' job duties are solely

focused on increasing value for the Company's shareholders and provide no discernable additional benefit to the Company's customers.

In addition, DESC capitalizes a portion of employee incentives and associated taxes for work related to plant-in-service. ORS requests the Commission require the Company, in future RSA filings, to identify and provide the capitalized incentives and associated taxes included in plant-in-service, accumulated depreciation and depreciation expense.

Capital Structure

S.C. Code Ann. § 58-5-440 contains requirements for the March Monitoring Report and states,

“(1) if the utility's earnings exceed the upper end of the range established in the order, the utility shall calculate the reduction in revenue required to lower its return on equity to the midpoint of the range established in the order; or (2) if the utility's earnings are below the lower range established in the order, the utility shall calculate the additional revenue required to increase its return on equity to the midpoint of the range established in the order.”

The range is 9.75% to 10.75% with a midpoint of 10.25% return on equity.

The Company included in the RSA filing the actual capital structure for the period ending March 31, 2019. This capital structure is comprised of 51.46% Long-Term Debt and 48.54% Common Equity. After reviewing the Company's balance sheet for this twelve-month period, ORS made no adjustment to DESC's capital structure for this period for purposes of the RSA.

In Order No. 2018-804, the Commission directed DESC to provide equity on an as-needed basis to maintain a capital structure for the Company that is comprised of between 50% and 55% common equity. ORS notes that, for this twelve-month period, the Company's equity ratio is below the minimum of this range and thereby recommends that DESC continue to work toward a ratio of common equity within the parameters established by the Commission in the above-referenced Order.

Excess Revenues

After the 2017 Tax Cuts and Jobs Act was passed into law, the Company's federal income tax rate decreased from 35% to 21%. From January 1, 2018 and continuing through October 31, 2018, the Company collected revenues from customers based on a 35% federal income tax rate. Through October 2019 the Company will return approximately \$3,893,151 to customers for excess revenue collected.

The Company calculated the value of excess tax revenue collected from April 1, 2018 through October 31, 2018 as \$3,887,084. This amount is returned to customers as a rate decrement beginning November 1, 2019. ORS does not propose any adjustment to the method in which the Company calculated the excess revenue of \$3,887,084.

Merger Impacts

Impacts from the recent Merger between South Carolina Electric & Gas Company and Dominion Energy, Inc. (Order No. 2018-804) are reflected in this RSA. Cost savings attributed to the voluntary retirement program totaled (\$1,700,000) are included. ORS verified the Company created a regulatory liability of \$2,450,000 as required by Order No. 2018-804 and issued the first of three (3) refunds in the form of a bill credit during the Review Period.

Rate Design and Allocation of Additional Revenue

S.C. Code Ann. § 58-5-440 states, “[t]he proposed rate changes, filed by the utility, shall conform as nearly as is practicable with the revenue allocation principles contained in the most recent rate order.” ORS reviewed the Company’s proposed tariffs for conformance, as nearly as practicable, to the revenue allocation principles set out in the Company’s most recent rate order, which is Commission Order No. 2005-619 in Docket No. 2005-113-G. If the Commission approves the findings of ORS’s examination, the Company would then apply the change in revenue amount in proportion to the Company’s Request using the same criteria. ORS will verify the new rates generate the approved revenue change.

Revenue Verification

ORS verified that the approved rates for April 1, 2018 through March 31, 2019 reflect actual revenues generated during the Review Period. Additionally, ORS verified the proposed revised tariffs in Exhibit B of DESC’s proposed rate adjustments will generate a revenue increase of \$7,106,649. ORS’s review determined the retail revenue target increase is \$6,273,054 instead of \$7,106,649 as proposed by the Company (See Exhibit A of the Company’s Request). ORS reduced the Company’s Request by \$833,595 or 11.73%. The results of ORS’s examination are shown on Schedule 1.

Conclusions

ORS reviewed DESC’s Monitoring Report and conducted an examination of the Company’s books and records. The revenue increase for DESC totals \$6,273,054 when applying the provisions of the RSA, ORS’ recommended adjustments and prior Commission order.

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Schedule 1

Dominion Energy South Carolina, Inc., Docket No. 2019-6-G
Operating Experience - Total Gas
For the Twelve-Month Period Ended March 31, 2019

<u>Description</u>	<u>Per Regulatory Books</u>	<u>Accounting & Pro Forma Adjustments</u>	<u>As Adjusted</u>	<u>Total Proposed Increase/ (Decrease)</u>	<u>Total After Proposed Increase/ (Decrease)</u>
<u>Operating Revenues</u>	\$ 426,200,934	\$ 3,945,015 (A)	\$ 430,145,949	\$ 6,273,054 (M)	\$ 436,419,003
<u>Operating Expenses:</u>					
O&M Expenses - Cost of Gas	241,166,214	0	241,166,214	0	241,166,214
O&M Expenses - Other	71,126,054	(2,498,265) (B)	68,627,789	0	68,627,789
Dep. & Amort. Expenses	31,884,224	817,976 (C)	32,702,200	0	32,702,200
Taxes Other Than Income	31,958,109	1,021,047 (D)	32,979,156	35,130 (N)	33,014,286
State Income Taxes	1,653,949	232,883 (E)	1,886,832	311,896 (O)	2,198,728
Federal Income Taxes	5,090,618	(451,030) (F)	4,639,588	1,244,466 (P)	5,884,054
<u>Total Operating Expenses</u>	382,879,168	(877,389)	382,001,779	1,591,492	383,593,271
<u>Total Operating Income</u>	43,321,766	4,822,404	48,144,170	4,681,562	52,825,732
Customer Growth	790,154	87,996 (G)	878,150	85,392 (Q)	963,542
Interest on Customer Deposits	(238,226)	0	(238,226)	0	(238,226)
<u>Net Income for Return</u>	43,873,694	4,910,400	48,784,094	4,766,954	53,551,048
<u>Rate Base:</u>					
Gross Plant in Service	1,278,536,676	(809,424) (H)	1,277,727,252	0	1,277,727,252
Reserve for Depreciation	480,463,814	599,719 (I)	481,063,533	0	481,063,533
Net Plant in Service	798,072,862	(1,409,143)	796,663,719	0	796,663,719
Construction Work in Process	37,172,913	0 (J)	37,172,913	0	37,172,913
Accum. Deferred Income Taxes	(96,282,607)	0	(96,282,607)	0	(96,282,607)
Environmental Costs	10,189,061	0	10,189,061	0	10,189,061
Pension Deferral	6,041,688	0	6,041,688	0	6,041,688
OPEB's	(18,438,894)	(23,177) (K)	(18,462,071)	0	(18,462,071)
Tax Deferrals	(80,666,668)	0	(80,666,668)	0	(80,666,668)
Injuries & Damages	(766,864)	0	(766,864)	0	(766,864)
Materials & Supplies	18,164,726	0	18,164,726	0	18,164,726
Total Working Capital	8,890,757	(312,282) (L)	8,578,475	0	8,578,475
Prepayments	11,505,604	0	11,505,604	0	11,505,604
Average Tax Accruals	(15,238,019)	0	(15,238,019)	0	(15,238,019)
Customer Deposits	(10,611,530)	0	(10,611,530)	0	(10,611,530)
<u>Total Rate Base</u>	668,033,029	(1,744,602)	666,288,427	0	666,288,427
<u>Rate of Return</u>	6.57%		7.32%		8.04%
<u>Return on Equity</u>	7.22%		8.78%		10.25%

Dominion Energy South Carolina, Docket No. 2019-6-G
Explanation of Accounting and Pro Forma Adjustments - Gas Operations
For the Twelve-Month Period Ended March 31, 2019

Schedule 2
1 of 3

Adj #	Description	Operating Revenues \$	Other O&M Expenses \$	Depreciation & Amortization Expenses \$	Taxes Other Than Income \$	State Income Taxes @ 5.0% \$	Federal Income Taxes @ 21% \$	Customer Growth \$	Gross Plant in Service \$	Reserve for Depreciation \$	Construction Work in Process \$	OPEB \$	Total Working Capital \$
<u>Accounting & Pro Forma Adjustments</u>													
1	Annualize Wages, Benefits, and Payroll Taxes Per Company Per ORS		(250,706) (250,706)		(17,753) (17,753)	13,423 13,423	53,558 53,558						(31,338) (31,338)
2	Remove Employee Clubs Per Company Per ORS			(15,638) (15,638)		782 782	3,120 3,120		(639,541) (639,541)	(268,972) (268,972)			
3	Recognize Property Retirements/Depreciation Reserves Per Company Per ORS												
4	Recognize Property Additions/Adjustments, Plant In Service Per Company Per ORS												
5	Annualize Depreciation/Depreciation Reserves Per Company Per ORS			837,227 837,227		(41,861) (41,861)	(167,027) (167,027)			923,770 923,770			
6	Annualize Property Taxes Per Company Per ORS				1,016,708 1,016,708	(50,835) (50,835)	(202,833) (202,833)						
7	Annualize Customer Awareness Campaign Expenses Per Company Per ORS		(23,346) (23,346)			1,167 1,167	4,657 4,657						(2,918) (2,918)
8	Annualize Health Care Expenses Per Company Per ORS		(846,135) (846,135)			42,307 42,307	168,804 168,804						(105,767) (105,767)
9	Annualize Other Post-Employee Benefits (OPEB) Per Company Per ORS		499 499			(25) (25)	(100) (100)					(374) (374)	62 62
10	Annualize Insurance Expense Per Company Per ORS		(308,784) (308,784)			15,439 15,439	61,602 61,602						(38,598) (38,598)
11	Tax Effect of Annualized Interest Per Company Per ORS					2,479 2,669	9,891 10,650						

Dominion Energy South Carolina, Docket No. 2019-6-G
Explanation of Accounting and Pro Forma Adjustments - Gas Operations
For the Twelve-Month Period Ended March 31, 2019

Schedule 2
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Adj #	Description	Operating Revenues \$	Other O&M Expenses \$	Depreciation & Amortization Expenses \$	Taxes Other Than Income \$	State Income Taxes @ 5.0% \$	Federal Income Taxes @ 21% \$	Customer Growth \$	Gross Plant in Service \$	Reserve for Depreciation \$	Construction Work in Process \$	OPEB \$	Total Working Capital \$
12	Annualize Current Pension Expense Per Company Per ORS		745,132 745,132			(37,257) (37,257)	(148,654) (148,654)						93,142 93,142
13	Remove Non-Recurring WNA Deferral Amortization Per Company Per ORS	2,630,022 2,630,022			13,839 14,728	130,809 130,765	521,928 521,751						
14	Annualize RSA Revenue Decrease (Order No. 2018-678) Per Company Per ORS	(5,166,965) (5,166,965)			(27,189) (28,935)	(256,989) (256,902)	(1,025,385) (1,025,037)						
15	Tax Reform-Annualize Excess Deferred Tax Amortization Per Company Per ORS						(1,380,229) (1,380,229)						
16	Tax Reform-Normalize Test Year Revenues Per Company Per ORS	3,887,084 3,887,084			20,454 21,768	193,332 193,266	771,393 771,131						
17	Annualize Pipeline Integrity Management Amortization Per Company Per ORS		759,008 759,008			(37,950) (37,950)	(151,422) (151,422)						94,876 94,876
18	Remove Impact of Gas Merger Credit Per Company Per ORS	2,450,000 2,450,000			12,892 13,720	121,855 121,814	486,203 486,038						
19	Timber Revenues Per Company Per ORS	144,874 144,874			762 811	7,206 7,203	28,750 28,741						
20	Remove Settlement Property Per Company Per ORS			(3,613) (3,613)		181 181	721 721		(169,883) (169,883)	(55,079) (55,079)			
21	VRP Merger Cost Savings Per Company Per ORS		(1,700,000) (1,700,000)			85,000 85,000	339,150 339,150						(212,500) (212,500)
22	Remove Non-allowable Expenses Per Company Per ORS		(53,106) (306,978)			2,655 15,349	10,595 61,242						(6,638) (38,372)
23	Adjust Employee Incentive Pay & Executive Salary Per Company Per ORS		0 (566,955)			0 28,348	0 113,107						0 (70,869)

Dominion Energy South Carolina, Docket No. 2019-6-G
Explanation of Accounting and Pro Forma Adjustments - Gas Operations
For the Twelve-Month Period Ended March 31, 2019

Schedule 2
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Adj #	Description	Operating Revenues \$	Other O&M Expenses \$	Depreciation & Amortization Expenses \$	Taxes Other Than Income \$	State Income Taxes @ 5.0% \$	Federal Income Taxes @ 21% \$	Customer Growth \$	Gross Plant in Service \$	Reserve for Depreciation \$	Construction Work in Process \$	OPEB \$	Total Working Capital \$
24	Customer Growth Per Company Per ORS							76,756 87,996					
25	Adjust Per Books OPEB Balance Per Company Per ORS											⁰ (22,803)	
Total Company Accounting & Pro Forma Adjustments		3,945,015	(1,677,438)	817,976	1,019,713	191,718	(615,278)	76,756	(809,424)	599,719	0	(374)	(209,679)
Total ORS Accounting & Pro Forma Adjustments		3,945,015	(2,498,265)	817,976	1,021,047	232,883	(451,030)	87,996	(809,424)	599,719	0	(23,177)	(312,282)

Total Proposed Increase/(Decrease)

26	Adjust Revenue, Taxes & Customer Growth Per Company Per ORS	7,106,649 6,273,054			37,395 35,130	353,463 311,896	1,410,316 1,244,466	96,761 85,392					
Total Company Proposed Increase/(Decrease)		7,106,649	0	0	37,395	353,463	1,410,316	96,761	0	0	0	0	0
Total ORS Proposed Increase/(Decrease)		6,273,054	0	0	35,130	311,896	1,244,466	85,392	0	0	0	0	0

Dominion Energy South Carolina, Inc., Docket No. 2019-6-G
Weighted Cost of Capital
For the Twelve-Month Period Ended March 31, 2019

Description	Regulatory Per Books					As Adjusted			After Proposed Increase/(Decrease)					
	Capital Structure	Ratio	Rate Base	Embedded	Income	Rate Base	Embedded	Overall	Rate Base	Embedded	Overall			
				Cost/Return	For Return		Cost/Return	Cost/Return		Cost/Return	Cost/Return			
Long-Term Debt	\$ 3,908,121,000	51.46%	\$ 343,769,797	5.95%	3.06%	\$ 20,454,303	\$ 342,872,025	5.95%	3.06%	\$ 20,400,885	\$ 342,872,025	5.95%	3.06%	\$ 20,400,885
Preferred Stock	100,000													
Common Equity	3,687,029,536	48.54%	324,263,232	7.22%	3.51%	23,419,391	323,416,402	8.78%	4.26%	28,383,209	323,416,402	10.25%	4.98%	33,150,163
Totals	\$ 7,595,250,536	100.00%	\$ 668,033,029		6.57%	\$ 43,873,694	\$ 666,288,427		7.32%	\$ 48,784,094	\$ 666,288,427		8.04%	\$ 53,551,048